L. R. B. & M. JOURNAL

VOLUME 28 NUMBER 3

MAY 1947

Policy of Issuing Special Amortization Certificates for Emergency Facilities for Thirty-five Per Cent or Any Percentage Less Than Entire Cost Unwarranted

Adequate Safeguards For Collecting and Disbursing Institutional Funds

Published by

LYBRAND, ROSS BROS. & MONTGOMERY

Accountants and Auditors

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Policy of Issuing Special Amortization Certificates for Emergency Facilities for Thirty-five Per Cent or Any Percentage Less Than Entire Cost Unwarranted

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Any taxpayer who has received a necessity certificate, under section 124 of the Internal Revenue Code, which included less than entire cost for special amortization purposes is the victim of an unwarranted policy and should not "take it lying down." In 1940 when there was desperate need for new war plants and machinery, the President and the Congress held out to taxpayers the privilege of amortizing the *entire cost* of any war facilities constructed or acquired. Taxpayers who received necessity certificates prior to 1944 were allowed to amortize entire cost, but many taxpayers who received certificates after 1943 were grossly discriminated against.

Although section 124 of the Code was enacted to permit a 5-year amortization[1] of the total cost of necessary war facilities acquired by taxpayers after December 31, 1939, the "rules of the game" were changed early in 1944 by administrative fiat. At that time administrative officers of the Government adopted a policy of permitting special amortization of only 35 per cent of the cost of any facility acquired thereafter if such facility was deemed to have post-war use. The financial detriment to tax-

[1]Section 124 provides for special amortization over a 5-year period or over the emergency period if the President proclaims the emergency at an end in less than 5 years. Since the President terminated the emergency for section 124 purposes in September, 1945, the total amount of the amortization deductions authorized by this section were available to taxpayers in the war years when high excess profits tax rates were in effect.

payers is at once apparent. It is the validity of that policy of 35 per cent certification of war facilities which this article proposes to examine.

1. Background of Section 124

Perhaps the most urgent problem facing the nation after the outbreak of war in Europe in 1939 was the mobilization of private industry to the production of war materials. There was a natural reluctance on the part of industrialists to abandon production of much-in-demand peacetime products for the uncertainties of war production. In many instances conversion meant the construction of new buildings, the acquisition of new machinery which might have little or no post-war use, and an almost inevitable period of trial and error before achievement of production in profitable quantities. Even if the new enterprise were successful, the new excess profits tax rates held promise of slim net profits. In 1940 the temper of the times was such that the owners of private capital were not inclined to undertake those risks. Most businessmen also had painful memories of the absolute failure of the provisions for special amortization in connection with similar activities in World War I, and of the very harsh policy of the Treasury with respect to the allowance of accelerated depreciation and obsolescence and loss of useful value of facilities.

It was in such setting that section 124 of the Internal Revenue Code was enacted in October, 1940. The section, generally speaking, provides that if a taxpayer acquires new plants or facilities after December 31, 1939, and a designated Government agency certifies that the new plants or facilities are "necessary in the interest of national defense during the emergency period," then the taxpayer, for income and excess profits tax purposes, may deduct the cost of the plants or facilities over a 5-year period or over the shorter emergency period specified in the statute.

The Chairman of the Committee on Taxation and Finance of the Advisory Commission to the Council of National Defense testified before the Senate Committee on Finance that "the sole purpose in recommending this amortization section . . . was to encourage the use of private capital in the construction of defense facilities."[2]

II. Original Interpretation

At the outset, section 124 was taken to mean that, if private capital was employed after 1939 to construct emergency facilities certified as necessary to national defense, the entire cost of those facilities could be deducted from income for tax purposes at the rate

[2]Hearings before Senate Committee on Finance on Second Revenue Act of 1940. 76th Cong., 3d Sess., p. 166.

of 20 per cent or more annually. Initially, the Secretaries of War and the Navy were given the task of determining whether the facilities were, in the language of section 124, "necessary in the interest of national defense during the emergency period." The Secretaries continued to act as certifying officers until December 17, 1943. During that period of approximately three years, both Secretaries issued certificates which expressly stated that the approved facilities were necessary in the interest of national defense up to 100 per cent of cost. Such certificates gave their holders the right, under subsection (a) of section 124, to amortize that cost at the rate of 20 per cent annually and when the emergency period was declared at an end prior to the elapse of five years to deduct the entire balance of the cost from net income.

III. Thirty-five per Cent Certification Adopted to Permit Amortization of "Excess War Cost" Only

On December 17, 1943, by executive order,[3] the authority to issue certificates was transferred to the War Production Board. Soon thereafter, the Board adopted the new certification policy heretofore mentioned. This the Board did without any change in the law, the executive orders, or the regulations issued thereunder authorizing such policy. The basic principle of the new policy was that facilities, although necessary in the interest of national defense, would not be certified for more than 35 per cent of total cost if it was reasonable to believe that the facilities would have post-war value. Thirty-five per cent, it has been explained by representatives of the War Production Board, represented the excess of war-time prices of facilities over the prices which would have been paid in the prior peacetime period. Such percentage is referred to by them as "excess war cost." In substance, then, the Board decided to use section 124 to compensate taxpayers, through special amortization, for only the higher war-time price they were compelled to pay by reason of purchasing the facility during the war, and not to give them any compensatory tax deduction for the amount arbitrarily determined as the normal pre-war cost of the facility.

It is submitted that the above-described certification policy of the War Production Board contravenes the specific terms of section 124 and is in direct violation of the express intention of the Congress in enacting the statute.

IV. The Meaning of Section 124

First, let us analyze the pertinent portions of section 124, which are the following:

[3]Executive Order 9406, 8 Fed. Reg. 16955 (1943).

SECTION 124. AMORTIZATION DEDUCTION.

(a) GENERAL RULE.—Every person, at his election, shall be entitled to a deduction with respect to the amortization of the adjusted basis (for determining gain) of any emergency facility (as defined in subsection (e)), based on a period of sixty months. . . . The amortization deduction above provided with respect to any month shall . . . be in lieu of the deduction with respect to such facility for such month provided by section 23(1), relating to exhaustion, wear and tear, and obsolescence.

* * * * * *

(e) DEFINITIONS.—

(1) EMERGENCY FACILITY.—As used in this section the term "emergency facility" means any facility, land, building, machinery, or equipment, or part thereof, the construction, reconstruction, erection, installation, or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made. . . .

(f) DETERMINATION OF ADJUSTED BASIS OF EMERGENCY FACILITY.—In determining, for the purposes of subsection (a) or subsection (h), the adjusted basis of an emergency facility—

(1) There shall be included only so much of the amount otherwise constituting such adjusted basis as is properly attributable to such construction, reconstruction, erection, installation, or acquisition after December 31, 1939, as either the Secretary of War or the Secretary of the Navy has certified as necessary in the interest of national defense during the emergency period, which certification shall be under such regulations as may be prescribed from time to time by the Secretary of War and the Secretary of the Navy, with the approval of the President.

It is plain that the first sentence of subsection (a) grants an absolute right to taxpayers to elect to make use of the 5-year amortization deduction. The right conferred is the right to deduct from income over the 5-year period the "adjusted basis (for determining gain) of any emergency facility (as defined in subsection (e))." The "adjusted basis (for determining gain)" will, in the case of facilities acquired for cash, be their cost. Thus, subsection (a) provides for deduction of the *cost* "of any emergency facility" over the 5-year period. Subsection (a) makes no mention of partial cost or of "excess war cost" of the emergency facility. In this connection, it is particularly significant that subsection (a) refers to the amortization deduction as "in lieu of the deduction . . . provided by section 23(1) [of the Code], relating to exhaustion, wear and tear and obsolescence." Likewise, subsection (c) gives the taxpayer the right to terminate the special amortization deduction and to return to the use of the depreciation deduction under section 23(1). There is not even an inference in either of these subsections that part of the cost of the emergency facility may be deducted under the amortization provision of section 124(a) and the balance deducted pursuant to the depreciation provision of section 23(1) of the Code.

To determine what facilities are "emergency facilities" with respect to which special amortization deductions may be taken, it is necessary to refer to subsection (e). The definition therein makes no men-

tion of cost, but defines the emergency facility (the cost of which is to be amortized under subsection (a)) to mean "any facility, land, building, machinery, or equipment, or part thereof, the construction . . . or acquisition of which was completed after December 31, 1939, and with respect to which a certificate under subsection (f) has been made." The obvious meaning of the definition is that facilities, land, buildings, etc., constructed or acquired after December 31, 1939, are entitled to the special amortization of cost (as provided by subsection (a)) if a *certificate* has been made with respect to the facility, land, building, etc.

The reference to a certificate pursuant to subsection (f) brings us to the heart of the controversy between the Government and taxpayers as to whether certificates may legally be issued under section 124 to cover only 35 per cent of the cost of emergency facilities rather than 100 per cent of cost. Subsections (a) and (e) plainly require that the facility be certified in order to entitle its owner to special amortization of its cost. The Government takes the position that subsection (f)(1) confers upon the certifying officer two discretionary powers: (1) to determine whether a facility is necessary in the interest of national defense; and (2) to determine the amount of the facility's total cost which may be amortized under subsection (a).

An analysis of the language and structure of the subsection will disclose the error of the Government's interpretation. Subsection (f)(1) contains two distinct provisions, but only one of those two provisions contains a grant of discretion. The first provision sets out a specific formula establishing the amount of cost ("adjusted basis") which "***shall be*** included" for amortization purposes under subsection (a). The second contains a grant of power to the certifying officer to determine, under regulations prescribed with the approval of the President, whether a facility is "necessary in the interest of national defense." It is in this latter provision only that administrative discretion is lodged. Thus, the first provision states in the *future tense* that there ***shall be included*** in the cost ("adjusted basis"), for amortization under subsection (a), all post-1939 costs of certain described facilities. The facilities referred to are described in the second provision of subsection (f)(1) in the following language: "such construction . . . or acquisition [i. e., facilities] . . . as either the Secretary of War or the Secretary of the Navy ***has certified*** as necessary in the interest of national defense . . ." The fact that the second provision relating to certification is expressed in the ***past tense*** in contrast to the future tense of the first provision is enough to demonstrate that the discretionary power given to certi-

fying officers with respect to the necessity of facilities is not to be related back to the first provision dealing with the amount of cost of certified facilities which may be amortized. In fact, the two parts are so distinct that it may be doubted that the certifying officer is entitled even to make reference to cost in his certificate. He certifies the facility, but certainly not the amount of cost used in determining the amortization deduction.

In summary, subsection (f)(1) states that the entire post-1939 cost of any facility certified as necessary by the Secretary of War or Navy will be included in measuring the amount of amortization which the taxpayer may deduct annually under section 124(a).

V. Congressional Intent as to the Meaning of the Statute

The foregoing interpretation of section 124 is in complete accord with the intent of Congress as shown by the legislative history surrounding its enactment. At the outset of the First World War in 1917, it had been necessary to provide a similar plan of special amortization in order to induce the investment of private capital in war production.[4] The plan devised at that time provided essentially for accelerated amortization of the difference between original cost and the post-war value of the facilities. In those cases in which the facilities were retained and employed in the post-war businesses of taxpayers, the Treasury was required to estimate the post-war "value in use" of such facilities. This requirement proved to be administratively unsatisfactory and even unworkable.[5] Because it postponed until after the war the final determination of what part of total facility costs would be entitled to accelerated amortization, accurate tax accounting, on a current basis, for either the war years or those immediately following was impossible.

These were the difficulties which the framers of similar legislation in World War II sought to avoid. Mr. David Ginsberg, Legal Adviser to the Price Stabilization Division of the Office of Emergency Management, stated the legislative intent in an address before the Practising Law Institute:

> "We were . . . determined not to support any law which would require post-emergency determinations and recomputations of the tax. We felt that it was necessary to offer some tax saving to industry to stimulate investment of private capital in the defense program. But we were firm in our opinion that the tax saving should be made definite and certain, at the outset, with no post-emergency recalculations, involving complicated problems of valuation."

Congressional committee hearings and reports are equally clear in showing that the Congress did

[4]Revenue Act of 1918, Section 234(a) (8).

[5]Sen. Rep. No. 27, 69th Cong., 1st Sess. (1926); Sen. Rep. No. 994, Pt. 2, 74th Cong., 1st Sess. (1935).

not intend that certified facilities which might have post-war use in peacetime business should be amortized over the emergency period on the basis of something less than 100 per cent of cost.

At hearings before the Senate Finance Committee[6] Hon. William S. Knudsen, a member of the Advisory Commission to the Council of National Defense, testified as follows:

"After most careful consideration, the Advisory Commission to the Council of National Defense has unanimously voted to recommend to your committee that *there not be included in the bill any provision limiting or restricting the use which a taxpayer may make of the facilities against which amortization or accelerated depreciation* has been charged pursuant to the terms of the bill.

* * * * *

"*If, at the end of the emergency, it turns out that plant facilities are useful for productive purposes during the emergency period only, the taxpayer is being only fairly dealt with by allowing him to charge off his plant against taxable income during the emergency period. If, however, the plant has productive use after the emergency period is terminated, there is no over-all advantage to the taxpayer in the rapid amortization because during the period after the emergency it will no longer be able to deduct depreciation or amortization on the plant,* it having already been completely written off for tax purposes." (*Italics supplied.*)

The report of the Ways and Means Committee which accompanied the Second Revenue Bill of 1940 when it was introduced in the House, stated in respect to section 124 that (H. R. Report No. 2894, 76th Congress, 3rd Session, p. 16):

"Under the bill, accordingly, a corporation is allowed a deduction for income and excess-profits tax purposes for the amortization of certain facilities which are certified . . . as necessary in the interest of national defense during the present emergency. . . . *The write-off of the cost (adjusted basis for income-tax purposes) of such facilities is permitted to be spread over a period of 60 months,* this deduction to be in lieu of the present deduction for exhaustion, wear and tear, and obsolescence provided for in section 23(1) of the Internal Revenue Code. . . ." (*Italics supplied.*)

Assistant Secretary of the Treasury John L. Sullivan testified before the Senate Finance Committee as follows:[7]

"Senator Vandenberg. * * * Why do you need new law?

"Mr. Sullivan: Because that law [the existing section 23 of the Internal Revenue Code] gives us the particular power in a restricted series of cases to confer special amortization.

"Now, under the proposal, the bill as it comes before you, in order for a manufacturer to secure this special amortization, the National Defense Council, plus either the Secretary of War or the Secretary of the Navy, must jointly certify that this new facility is necessary to national defense.

"Senator Vandenberg: Well, then, this new statute is a limitation upon the power you already have?

"Mr. Sullivan: I think not, sir.

"Senator George: Just a minute, Mr. Sullivan. You say it is necessary for them

[6]Hearings before Senate Finance Committee on Second Revenue Act of 1940, 76th Cong., 3d Sess. (1940), p. 159.

[7]Hearings before Senate Finance Committee on Second Revenue Act of 1940, 76th Cong., 3d Sess. (1940), p. 124.

to certify that it is necessary to national defense. Do they stop there?

"Mr. Sullivan: I beg your pardon.

"Senator George. *Is the certificate that is issued on the recommendation of the National Council and the Secretary of War or Navy, as the case may be, limited to mere certification that the particular facility is necessary for defense, or do they go further and specify what the depreciation and obsolescence amounts to.*

"Mr. Sullivan: No; they do not.

"Senator George: They turn that back to the Treasury?

"Mr. Sullivan: *No, sir; under the bill automatically the amortization to which they are entitled is 20 per cent a year, for five years.*" (*Italics supplied.*)

The meaning of the foregoing statements is plain. Congress, in enactment of section 124, intended to authorize special amortization of the entire cost of war facilities over the emergency period without regard to their post-war usefulness in peacetime operations. In fact, it is apparent from the exchange of remarks between Senator George and Assistant Secretary of the Treasury Sullivan, quoted above, that Congress did not intend the certifying officer to have any control over the amount of cost which would serve as the basis for amortization. Rather, the discretion of the certifying officer was intended to be limited to a determination of the necessity of the facility in the interest of national defense. Once the fact of necessity is established, the discretionary function of the certifying officer is at an end.

VI. Administrative Justification for Thirty-five Per Cent Certifications

How, then, can the War Production Board and its successor agencies defend the policy of writing into necessity certificates a limitation which denies the special amortization benefits of section 124 to all except 35 per cent of the total cost of an emergency facility?

The former acting Chief of the Tax Amortization Branch of the War Production Board has recently attempted to explain the basis for the 35 per cent certification policy.[8] He states that by the spring of 1943 expansion of facilities for essential war production had been virtually completed with the exception of certain special programs, some specialized machinery and further expansion in raw materials production. Therefore, in December, 1943 an Executive Order[9] was promulgated which specified that necessity certificates should not be issued unless prior to construction or acquisition the Chairman of the War Production Board had determined

[8]The explanation summarized herein is contained in an affidavit executed by Sidney T. Thomas, Chief Tax Amortization Branch, Civilian Production Administration, on December 27, 1946, and was filed by the Government in the Federal District Court for the District of Columbia in the case of *The United States Graphite Company* v. *Philip B. Fleming, Temporary Controls Administrator, Tax Amortization Branch, Office of Temporary Controls.*

[9]Executive Order 9406, 8 F. R. 16955.

(1) that the facilities were clearly necessary for the war effort, and (2) that it was to the advantage of the Government that the facilities are privately financed. In passing, it may be noted that the first of these determinations is substantially the same as that which previous certifying officers had made in their statutory determination that facilities are "necessary in the interest of national defense."

It is on the second determination requirement—that it be to the advantage of the Government to have the facilities privately financed—that Government officials primarily rely for justification of certification of only 35 per cent of cost. The administrator continues his explanation by stating that a tremendous advantage was to be gained by any manufacturer who could build up a post-war plant at the expense of war-time income through the rapid amortization of section 124. Adoption of the new policy was based upon the ground that many war facilities would have post-war utility either to their owners or to others to whom they could be sold. In such cases, says the administrator, it was decided to grant only partial certificates because under certification of the entire cost the Government, through special amortization, might bear as much as 85 per cent of the cost through tax deductions, thereby suffering a substantial loss of revenue. The Government's statement of policy contains the categorical assertion that partial certification was intended "to cover a liberal allowance for the excess cost of war-time acquisition or construction as compared with normal or prewar (1937–1939) costs." It is further stated that "after surveys of current prewar costs of many types of facilities, partial certification has been standardized at 35 per cent of current costs."

In its explanation the Government entirely overlooks the fact that the reasons advanced for adoption of partial certification in 1944 were equally applicable to emergency facilities in all preceding years. Facilities constructed or acquired in 1940, 1941, 1942 and 1943 also had post-war utility in many instances; the loss of revenue to the Government was just as great. If the certifying officers, in fact, possessed any control over costs and the reasons advanced for the partial certification policy in 1944 are valid, it appears they were equally valid in 1940.

However, even a casual examination of the policy statement will disclose that the policy of partial certification is directly contrary to the expressed intention of the Congress at the time section 124 was enacted. The fact that many of the certified facilities would have post-war utility was recognized by the framers of the legislation and pointed out to the Congress. Nonetheless, the Congress decided that

special amortization should be granted to such facilities without regard to their post-war value. The Congress and the Executive specifically wished to avoid the "value in use" policy of the World War I statute. Furthermore, the legislative history, as quoted heretofore, establishes beyond question that once the certifying officer has determined that the facility is necessary in the interest of national defense, section 124 was intended to operate *automatically* to entitle taxpayers to deduct annually 20 per cent of the total cost of such facility over the 5-year period or at a higher percentage for a shortened emergency period.

Moreover, the question of whether it is to the advantage of the Government to have a facility "publicly" or "privately" financed does not, and cannot, affect the automatic operation of the amortization provisions of section 124 in the manner suggested by the Government.

Whatever the justification, the policy of certifying only "excess war cost" on the theory of post-war utility has no foundation in the statute or in the legislative history of its enactment. Its adoption constitutes a plain administrative usurpation of the legislative function. The reasons advanced for its adoption might properly be directed to the Congress in a request for amendment or repeal of the statute, but they do not justify an interpretation which has no basis either in the language of the existing statute or in Congressional intent.

VII. Do Taxpayers Who Received 35 Per Cent Certificates Have a Legal Remedy?

If, as heretofore concluded, certificates permitting special amortization of only 35 per cent of the cost of war facilities are invalid, can legal steps be taken to obtain 100 per cent amortization?

Taxpayers who hold necessity certificates from the War Production Board or its successor certifying agencies should by all means seek advice as to how to protect their right to have amortization of 100 per cent of cost.

At least one taxpayer has brought an action in Federal District Court to compel the certifying officer to correct his 35 per cent certificate to show on its face that he is entitled to amortize 100 per cent of the cost of the necessary facility under section 124.[10] The action is in the nature of a mandamus proceeding to obtain a Court order requiring the certifying officer to correct the face of the certificate. In that proceeding the Government has admitted that the 35 per cent certificates do not represent a determination of the certifying officer that

(*Continued on page 20*)

[10] *The United States Graphite Company* v. *Philip B. Fleming, Temporary Controls Administrator*, Civil Action No. 36695.

Adequate Safeguards for Collecting and Disbursing Institutional Funds

By C. R. Giles
(*San Francisco Office*)

The setting up of adequate safeguards for collecting and disbursing funds is based on certain fundamental principles of division of duties, formalized instructions and routines, and supervision. But there is no precise pattern that can be fitted to all types of enterprises. A business with many employees automatically has better control than one in which the office work is done by two or three people. The controller of a manufacturing concern will have a system materially different in its details from that of a department store.

In establishing adequate controls over the university's funds, the business officer must give due recognition to the variations and peculiarities inherent in colleges and universities. Before going into the general subject of cash controls, let us consider some of these variations and peculiarities.

The educational institution should recognize that its very nature places on the business office the major portion of the function of adequate controls. The college is primarily a service organization, and its activities are not for the purpose of realizing profits. In commercial enterprises, however, revenues are produced by expenditures, resulting in a profit or a loss and ordinarily there is a direct relationship between income and expenditures. Under such circumstances, the controller in an industrial concern can expect that the plant superintendent will currently watch his production costs in relation to units produced; the credit manager will investigate a slowing-up of cash collections; and the president will be vitally interested in knowing the reason why the gross profit on Product A went down three per cent last month. The industrial system of accounts and financial statements permits this to a greater degree than that of the college or university.

The educational institution may have an infinitely greater variety of functions than a commercial enterprise of the same size. Quite apart from the main job of accounting for the workings of an educational system the business officer may also be the chief accounting officer responsible for adequate controls for:

1. Intercollegiate athletics. Here he has some of the problems of the theatre manager. Does he have all the available controls peculiar to this field? For example:

   (a) Are football ticket applications processed promptly and the cash deposited at once?

(b) Could the ticket-dispensing mechanisms common in theatre box offices be used?

(c) Are the safeguards available through use of metered turnstiles availed of?

(d) Is there accounting control over printing of all tickets?

(e) Are all tickets, once printed, accounted for?

(f) Is the practice of complimentaries formalized in a routine, and is the routine adhered to?

2. A hotel, i. e., dormitories, dining halls, and cafeterias. Does the system in effect include the following safeguards:

(a) Can housekeepers' reports of rooms and/or beds serviced be sent direct to accounting for comparison with recorded income totals? If this is not practicable or applicable, could there be a check with dormitory assignment records in the Dean of Students office?

(b) Are cash registers utilized to the fullest extent?

(c) Is volume in dining rooms great enough to warrant the use of a food checker?

(d) Is there numerical control over dining room checks for visitors?

3. A hospital. Here one of the chief problems is that of determining that all of the many services furnished a patient are being collected for. The following suggest themselves:

(a) A check of room billings against daily condition sheets made up by head nurses.

(b) A check of operating room fees against the operating room register which shows, usually by quarter hours, the schedule of operations for the day.

(c) Numerical control over charge slips from pathological, X-ray, and other laboratories.

Tuition income is, of course, one of the major sources of income. There is nothing quite like it in a commercial enterprise. Its uniqueness lies in the fact that it is usually collected in advance, much of it is received in cash, and its collection is ordinarily not preceded by the issuance of a bill by the accounting department. Procedures should provide a control over the following possibilities.

1. A student manipulates his registration in such a way that he can attend classes and obtain grades, and ultimately a degree, without paying tuition fees.

2. Assuming that the foregoing is impossible because the registrar will not give out grades unless he has received due notice of tuition fee collection from the business office, an accounting clerk pressed into temporary cashier duties on registration day pockets a student's fee, which is in the form of currency, but still keeps the record of tuition fee collection on its route to the registrar.

3. May some one in the registrar's office establish records giving his cousin a free college education?

The educational institution has a major problem in the matter of gifts. The following basic procedures are suggested:

1. If the college or university has a separate fund-raising or soliciting organization or committee, it should furnish the accounting department currently with information relating to prospective gifts, inclusion in wills, commitments by foundations, etc.

2. A gift in cash should be entered and deposited at once. How many instances come to your mind of a check going from one person to another for an indefinite period

while attempts are being made to determine the purpose of a gift and the account to which it should be credited?

3. A multi-copy receipt form should be prepared as the gift is recorded and copies distributed as follows:

(a) One to the Secretary of the Board of Trustees for formal recording in the minutes.

(b) One or more to the President, for acknowledging and filing.

(c) One to the fund-raising organization or committee, for posting to its records.

(d) One or more copies for accounting use.

Investment income is usually of sufficient importance to the university or college to warrant procedures for regularly accruing such income, particularly interest and rents, in the accounts currently, rather than taking them up on a cash basis. Dividend income ordinarily will be taken up on a cash basis, and the annual income should be checked with one of the printed dividend summaries put out by various investment services.

The university business officer should have in effect special procedures to assure receipt of all collections on student loans. He ordinarily has no credit manager, and the general policy of the institution may be one of leniency and no pressure. The general rules of business, such as the statute of limitations, are not particularly applicable, as witness the numerous instances of collections on such loans many years after graduation. The business office should continue to exercise control, and maintain contact through correspondence, after a student loan has been removed from the accounts as uncollectible.

The largest single class of disbursement by an educational institution is ordinarily payroll. Would it be worthwhile for some one in the business office, not engaged in any phase of payroll preparation, to personally distribute all pay checks, say, in the month of May, and thus verify the existence of all persons listed on the payroll? If personal distribution is not feasible, direct mailing is suggested.

In spite of differences and special conditions such as the foregoing, there are certain sound and fundamental principles of cash control applicable to all effective accounting systems.

How well safeguarded the funds of any organization, profit or nonprofit, are depends on the efficient and complete functioning of the following:

1. The system of internal check as incorporated in the accounts and office procedures;
2. Internal audits; and
3. Independent audits.

The following comments are limited to a discussion of the first-named. I should like first, however, to quote some authorities on the interrelation of all three:

From the Report of the Special Committee on Terminology of the American Institute of Accountants:

Internal Check: A system under which the accounting methods and details of an establishment are so laid out that the accounts and procedures are not under the absolute and independent control of any one person—that on the contrary, the work of one employee is complementary to that of another—and that a continuous audit of the business is made by employees.

Internal Audit: The term refers to an audit made by members of the concern "audited". Frequently "staff auditors", "traveling auditors", or "inspectors" are employed to make continuous or periodical audits of some or all of the transactions. The scope is not definite, and their work is frequently supplemented by examinations made by public accountants.

From "Auditing of Colleges and Universities" by J. Harvey Cain, published by the Financial Advisory Service of the American Council of Education:

The financial operations of every publicly controlled and privately controlled college are of sufficient importance to require periodic auditing. . . . An independent audit guards against serious forms of laxity and dishonesty, and has a tendency to improve order, and budgetary control. . . . The auditor should carefully examine and evaluate the system of internal control within the college organization. A proper internal audit system which is carefully and intelligently administered is one of the surest ways of safeguarding the college's finances. . . .

One of the first steps in safeguarding cash receipts is to get some positive record of it as soon as received. Recording it establishes accountability, thus it is essential that the record be made promptly. In the case of mail remittances, the person opening the mail should make the record, and turn the record over to the accounting department and the remittances over to the cashier. If the cashier is the first person to receive the cash, the record should be a receipt form in duplicate, or registration on a cash register or other mechanical device. An important part of recording is the valuable publicity feature that can accompany it. A cash register rung up in front of the person who has just paid out some hard-earned cash is one of the most effective deterrents to shortages ever devised. Of somewhat comparable value is the practice of always giving a serially-numbered receipt form.

All cash receipts should be deposited intact. It may seem unnecessary at times to maintain a separate cash fund for cashing checks for accommodation when the current day's receipts has plenty of currency for such purpose, but one cannot overlook the potential danger of ever permitting any substitutions of cash receipts. As a record and source of proof that cash receipts are being deposited intact, there should be a requirement that the deposit ticket be made up in duplicate, with a copy to be signed by the bank and sent direct to the accounting or auditing department, where its composition can be compared from time to time with cash receipts detail.

All cash receipts should be deposited daily. It is a simple rule (and one that can be followed up and

verified very easily by reviewing the credits on the monthly bank statements) to require that every day at 2 P.M. (or some other established time) the receipts for the preceding twenty-four hour period be deposited. There are, of course, a number of advantages in such a rule in addition to that of internal check, e. g., the reduced burglary hazard. The matter of prompt deposit of collections should be given special attention at outlying or branch collection points, such as athletic departments, bookstores, etc.

The function of receiving cash should be centralized to the greatest degree possible. When many individuals receive cash, the cash collection may be a sideline to other activities and the chance of error or laxity is greater.

Persons receiving cash should not have access to regular accounting records. Cashiers should do no further accounting than the preparation of reports summarizing the cash transactions. All persons handling any phase of cash work should be required to take annual vacations.

All checks received should be made payable to the institution (prominently displayed signs in the cashier's office help) and depositaries should be instructed to accept such checks for deposit only.

Just as it effects better control for the bank to report the amount of the daily deposit, by means of the duplicate deposit ticket, to the accounting or auditing department, it is also good practice to have the bank report direct to the accounting department on any charge-backs for bad checks, uncollected drafts, etc.

Transfers between banks should be systematic. Withdrawals from branch depositories (e. g., a bank in which athletic department or hospital receipts are deposited) should be restricted to transfers to central disbursing banks, and should preferably be on an automatic remittance basis.

Disbursements should be made by check to the fullest degree possible. Disbursements from petty cash funds should be scrutinized from time to time to determine whether certain regular disbursements could not be handled just as well by check.

Authorized signatures should be given continuing attention. Banks should be notified promptly when some one on the authorized signature list is removed from the payroll. The use of signature dies requires careful control. Double signatures on checks are of less value than one signature if the first is made on blank checks because the person will not be available later for signing. It is possible that the second signature may be affixed on the assumption that the purpose of the disbursement was closely scrutinized by the first signer.

The form and use of checks should be given attention. Protective paper should be used. There

should be full and complete accounting for numerical sequence. The completed checks should be mailed direct by the signer to the named payees. Voucher data supporting the disbursement should always accompany the check to be signed, and the check signer should examine such data before signing.

Minor manipulations of petty cash funds are quite often the start of major irregularities, and the following matters should be given consideration:

1. Is the fund sufficiently minor and restricted to personal disbursements that the custodian may merge it with his personal funds? If so, there should be periodic reminders of ownership of the fund by requesting the custodian to acknowledge it.

2. If the fund is large enough to warrant placing a part of it in a bank account it should be formally established with the bank that it is institutional funds, and the monthly bank statements should be sent direct to the accounting office.

3. Is there a rigid rule regarding IOU's and personal checks in the fund?

4. Are petty cash reimbursement vouchers carefully reviewed as to completeness and authorizations?

All disbursements should be supported by complete and appropriate documentary evidences. An invoice for material should have associated with it the related purchase order and evidence of receipt of the material or appropriate entry on the invoice itself that there had been this association. All voucher data should be effectively cancelled, e. g., with a perforating device cutting the voucher reference in the paper at the time of payment to avoid the possibility of re-use.

Bank statement reconciliation work should be done by a person who is connected with neither cash receipts nor cash disbursement details. He should receive the bank statement direct. The reconciliation work should be done currently, otherwise recoveries on account of irregularities may be denied by the courts. Endorsements should be scrutinized. The actual mechanics of bank reconciliation are important. A backward reconciliation, i.e., listing missing check numbers from the numerically arranged paid checks and related amounts, is faster than checking the pay checks against the cash disbursements detail, and listing outstandings from the latter, but it will not disclose checks payable to others than the names shown on the cash disbursement detail. Also, it is faster to check paid checks against a check register than against the actual voucher detail, but from time to time the latter procedure should be followed. All bank transfers should be carefully checked to determine that there are simultaneous deposit and withdrawal entries for each transfer.

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The L. R. B. & M. Journal

Published by Lybrand, Ross Bros. & Montgomery, for free distribution to members and employees of the firm.

The purpose of this journal is to communicate to every member of the staff and office plans and accomplishments of the firm; to provide a medium for the exchange of suggestions and ideas for improvement; to encourage and maintain a proper spirit of cooperation and interest, and to help in the solution of common problems.

Quarter Century Club

Mr. William D. Buge and Mr. Harold L. Hoffman have completed twenty-five years of association with our Chicago office. Watches, engraved with the dates on which they became members of the Quarter Century Club, have been presented to them. There are now three men in the Chicago office who are members of the Club.

Notes

Andrew Greene, of our Chicago staff, died on March 25, 1947, at the age of sixty-three years. He had not been in good health for several years and finally succumbed to his many ailments. Mr. Greene was on the staff of our Philadelphia office from 1907 to 1913 and from 1927 to 1929, when he transferred to Chicago. He specialized in banks, and investment and brokerage houses, and handled many engagements for such clients. He made many friends during his long service with the firm, and his talent, loyalty and interesting personality will be greatly missed by them.

Our sympathy is extended to the members of Mr. Greene's family in their bereavement.

Mr. Russell spoke before the Decatur Chapel of the National Association of Cost Accountants at Springfield, Illinois, on February 19, 1947, on the subject "Principles of Inventory Valuation."

On April 25, 1947, Mr. Russell addressed the Schoolmaster Club of Michigan, at Ann Arbor, on "Business Ethics."

Mr. Richardson spoke before The Second Annual Conference on Federal Taxation which was held in Miami Beach in April. His subject was "Minimizing Taxes in Operating a Business."

Mr. Halloran was discussion leader at the Study Club of the Louisville chapter of The National Association of Cost Accountants on April 22, 1947. The subject of the meeting was Production Data and Product Cost.

On April 29, 1947, Mr. C. R. Giles, of our San Francisco staff, presented a paper on "Adequate Safeguards for Collecting and Disbursing Institutional Funds" at the 1947 convention of the Western Association of College and University Business Officers, held in San Francisco. His paper appears in this issue of the JOURNAL.

On May 10, 1947, Mr. R. G. Ankers of our New York staff, spoke on "The Accounting Profession" before a vocational class at New York University.

Mr. Ankers has been elected an honorary member of the national accounting fraternity, Beta Alpha Psi (New York University Chapter).

Mr. Jennings has been appointed a member of the American Institute of Accountants' Committee on Selection of Personnel.

Mr. Richardson is chairman of a special committee on tax policy and practice which was recently appointed by the president of the American Institute of Accountants. The committee is to develop a program for keeping business men and the general public informed of attempts to curtail legitimate practice of certified public accountants in the tax field.

Mr. McCullough has been nominated for reelection as a Director of The Michigan Association of Certified Public Accountants.

Mr. H. G. Huffman, of our Detroit staff, is Chairman of The Education Committee of The Michigan Association of Certified Public Accountants.

Mr. Oliver O. Howard, a member of our Louisville staff since December 16, 1937, has been appointed Controller of Ballard & Ballard Company.

The following members of our organization have been elected to membership in the American Institute of Accountants:

William F. Scheid, Jr., *Philadelphia.*
Harrison F. Spengler, *Detroit.*
Norman T. White, *Philadelphia.*

Mr. Harry F. Topping, of our Chicago staff, passed the November 1946 Illinois C. P. A. examination and has been awarded his certificate.

Mr. Gerald B. Davis, of our New York staff, has been elected to membership in The New York State Society of Certified Public Accountants.

Mr. Donald S. Erion, of our Detroit staff, is a member of the Tax Committee of the Junior Chamber of Commerce in Detroit.

Thirty-five Per Cent Special Amortization

(*Continued from page 10*)

only 35 per cent of the facility was necessary, and instead are intended to show that the entire facility mentioned in the certificate was determined to be necessary, but for policy reasons it was deemed desirable to certify only 35 per cent of the cost for special amortization purposes. Thus, the Court record will disclose that the certifying officer has already exercised the only discretionary authority conferred upon him by section 124, namely, to determine that the entire facility is necessary in the interest of national defense. This fact makes it plain that the Court is not being requested by the taxpayer to interfere with any discretionary authority of the certifying officer. Therefore, there is no legal obstacle to issuance by the Court of a mandatory order directing the certifying officer to perform the purely ministerial act of correcting the face of the certificate to conform to the requirements of section 124.

Once the face of the certificate has been corrected to show, without ambiguity, that the entire facility has been certified as necessary, there should be no difficulty in obtaining special amortization deductions for the entire cost pursuant to the plain terms of section 124.

Safeguards for Institutional Funds

(*Continued from page 16*)

As previously mentioned, the foregoing general principles will apply, in varying degree of course, in all types of enterprises, profit or nonprofit. And, in conclusion, it cannot be too strongly emphasized that the most carefully conceived and complete system of internal check needs constant supervision and review to keep it functioning.

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